

SUBCOMMITTEE NO. 1 on Education



Subcommittee No. 1
Chair, Jack Scott
Member, Bob Margett
Member, Joe Simitian

Tuesday, March 6, 2007
1:30 p.m.
Room 113, State Capitol

<u>Item</u>	<u>Department</u>	<u>Page</u>
	Overview of Governor's Education Budget – Acting Secretary for Education, Scott Himmelstein & Department of Finance, Jeannie Oropeza	
	K-12 Budget Priorities -- Superintendent of Public Instruction, Jack O'Connell	
6110/6870 Issue 1	Department of Education & California Community Colleges Proposition 98 and K-12 Education Funding Overview – Office of the Legislative Analyst, Jennifer Kuhn	Page 2
6110 Issue 2	Department of Education Major Adjustments – Student Enrollment	Page 6
Issue 3	Major Adjustments – Declining Enrollment Districts	Page 8
Issue 4	Major Adjustments – Cost-of-Living Adjustments (COLAs)	Page 9
Issue 5	Funding Shift – Home-to-School Transportation	Page 10
Issue 6	Education Mandates – Annual Payments	Page 11
Issue 7	Education Mandates – Prior-Year Payments	Page 13
Issue 8	Implementation Update: Status of New One-Time Funds in 2006-07	Page 14
Issue 9	Implementation Update: Status of New Ongoing Funds in 2006-07	Page 15

Pursuant to the Americans with Disabilities Act, individuals who, because of a disability, need special assistance to attend or participate in a Senate Committee hearing, or in connection with other Senate services, may request assistance at the Senate Rules Committee, 1020 N Street, Suite 255 or by calling 916-324-9335. Requests should be made one week in advance whenever possible.

ITEM 6110 DEPARTMENT OF EDUCATION

ISSUE 1: Proposition 98 & K-12 Funding – Overview

DESCRIPTION: The LAO will summarize the Governor’s budget proposal for Proposition 98 and K-12 education in 2007-08 and present their overall recommendations.

BACKGROUND: Funding for California’s public elementary and secondary education system is administered predominantly through the California Department of Education (CDE), under the direction of the Superintendent of Public Instruction and the State Board of Education. The public elementary and secondary education system educates approximately 5.9 million students enrolled largely in kindergarten through 12th grade. The primary goal of the Superintendent and the CDE is to provide policy direction to local school districts and to work with the educational community to improve academic performance.

At the local level, K-12 education is the responsibility of nearly 1,000 school districts, 58 county offices of education, and more than 9,300 schools. Approximately 307,800 teachers are employed in public schools statewide.

Total K-12 Funding (All Funds)

The 2007-08 Governor’s Budget proposes \$68.6 billion in total funding for K-12 education, which reflects an increase of \$1.8 billion (2.7 percent) above 2006-07 revised budget. The Department of Finance estimates that average per-pupil funding from all sources (state, local, federal, other) totals \$11,584 in 2007-08, an increase of \$344 above the \$11,240 per-pupil amount in 2006-07.

Table 1					
K-12 Summary, All Funds	Actual	Revised	Proposed		Percent
<i>(dollars in millions)</i>	2005-06	2006-07	2007-08	Amount	Change
K-12 Proposition 98:					
State General Fund	\$34,582	\$36,658	\$36,851	\$193	0.5
Local Property Taxes	11,959	12,353	13,595	1,242	10.1
Subtotal, Proposition 98	(\$46,541)	(\$49,011)	(\$50,446)*	(\$1,435)	(2.9)
Other K-12 Funds:					
State General Fund (Non-98):					
Teacher Retirement	\$999	\$876	\$966	\$91	10.4
Bond Payments	1,681	1,857	2,201	345	18.6
Other Programs	160	554	413	-140	-25.4
State Lottery Funds	1,036	1,012	1,012	0	0
Federal Funds	6,931	7,113	6,568	-545	-7.7
Other	6,147	6,352	6,948	596	9.4
Subtotal, Other Funds	(\$16,954)	(\$17,763)	(\$18,109)	(\$346)	(1.9)
Total , All Funds	\$63,495	\$66,774	\$68,555	\$1,781	2.7
K-12 ADA	5,964,108	5,940,989	5,917,948	-23,041	-0.39
Per Pupil Funding, All Funds	\$10,646	\$11,240*	\$11,584*	\$344	3.1

* Reflects the funding shift of \$627 million in funding for Home-to-School Transportation from Proposition 98 to the Public Transportation Account per the Governor’s proposal. Without the shift, the K-12 Proposition 98 increase would total \$2.1 billion (4.2 percent).

As reflected in Table 1, the \$68.6 billion in total funds for K-12 education can be summarized as follows: \$42.1 billion (61.4 percent) in state funds (General Fund and State Lottery Fund); \$19.9 billion (29 percent) in local funds (property taxes and other local revenues); and \$6.6 billion (9.6 percent) in federal funds.

The budget reflects a decrease of \$545 million (7.7 percent) in federal funds, although this figure will be updated by the Department of Finance April Letter and/or May Revise to reflect new amounts in the federal Labor, Health and Human Services (HHS), and Education appropriations bill for federal fiscal year 2007, that was just passed by Congress and signed by the President in February 2007.

Proposition 98

Total Proposition 98 funding for K-14 education in 2007-08 is proposed at \$56.8 billion, an increase of \$1.8 billion, or 3.3 percent, over the revised 2006-07 budget. (See Table 2) The Administration states that this level of funding meets the Proposition 98 minimum funding guarantee in 2007-08, as currently estimated by the Department of Finance.

Table 2

K-14 Proposition 98

Appropriations Summary

(dollars in thousands)

	2005-06	2006-07	Proposed 2007-08	\$ Change	% Change
<i>Distribution of Prop 98 Funds</i>					
Department of Education	\$46,485,854	\$48,945,279	\$50,385,924*	\$1,440,645	2.9
Community Colleges	5,472,403	5,897,062	6,274,142	377,080	6.4
Corrections & Rehabilitation**	45,780	52,964	54,250	1,286	2.4
State Special Schools	42,567	44,533	44,253	-280	-0.6
Commission on Teacher Credentialing	31,814	49,881	39,881	-10,000	-20.0
Dept. of Developmental Services	10,217	9,121	8,677	-444	-4.9
Dept. of Mental Health	18,400	13,400	18,400	5,000	37.3
School Facilities Aid Program	7,841	5,766	5,015	-771	-13.3
Am. Indian Education Centers	4,698	4,343	4,518	175	4.0
Total	\$52,119,574	\$55,022,369	\$56,835,060	\$1,812,691	3.3

Prop 98 Fund Source

State General Fund	\$38,358,017	\$40,812,023	\$41,189,857	\$377,834	0.9
Local Property Taxes	13,761,557	14,210,346	15,645,203	1,434,857	10.1
Total	\$52,119,574	\$55,022,369	\$56,835,060	\$1,812,691	3.3

K-12 Enrollment-ADA***	5,964,108	5,940,989	5,917,948	-23,041	-0.39
------------------------	-----------	-----------	-----------	---------	-------

K-12 Funding per ADA****	\$7,803	\$8,293	\$8,569	\$276	3.3
--------------------------	---------	---------	---------	-------	-----

* Includes one-time funds for prior year Proposition 98 settle-up.

** Division of Juvenile Justice. (Formerly California Youth Authority.)

*** Average Daily Attendance

**** Includes one-time funds for prior year Proposition 98 settle-up. Without these one-time funds, K-12 per ADA funding totals would equal \$8,250 in 2006-07 and \$8,524 in 2007-08.

The Governor proposes to shift \$627 million in funding for the Home-to-School Transportation program – administered by the California Department of Education – from the Proposition 98 General Fund to the Public Transportation Account. In making this shift, the Administration proposes to rebench the Proposition 98 minimum guarantee downward by \$627 million.

Of the \$56.8 billion in Proposition 98 spending for K-14 education in 2007-08, \$50.4 billion is appropriated to the Department of Education for K-12 schools; \$6.3 billion for Community Colleges; and \$175 million for all other state education agencies.

General Funds comprise \$41.2 billion (72.5 percent) of total Proposition 98 funding; property taxes comprise the remaining \$15.6 billion (27.5 percent).

The number of students in K-12 schools, as measured by unduplicated average daily attendance (ADA), is estimated to decrease by 23,041 in 2007-08, a decrease of 0.39 percent over the revised 2006-07 budget. Average per-pupil Proposition 98 funding is estimated to be \$8,569 in 2007-08, an increase of \$276 (3.3 percent) above the revised 2006-07 level of \$8,293.

Comments:

- **Lottery Funds Predicted to Decline in 2007-08.** Education programs (K-12 education and higher education) currently receive more than \$1.2 billion in state lottery funds. These funds can be used for a variety of purposes, although some funding for K-12 and community colleges must be set-aside for instructional materials. State lottery revenues have been increasing in recent years. However, according to the LAO, the Lottery Commission issued a statement in February that they were lowering their lottery fund estimates downward by **\$136 million** in 2006-07 due to lower than expected revenues for the state lottery.
- **Federal Funds Update to Reflect New Federal Appropriations Bill for Education.** The budget reflects a decrease of \$545 million (7.7 percent) in federal funds, although this figure will be updated by the Department of Finance April Letter and/or May Revise to reflect new amounts in the federal Labor, Health and Human Services (HHS), and Education appropriations bill for federal fiscal year 2007, that was just passed by Congress and signed by the President in February 2007. The Department of Education will provide a federal funds update at the Subcommittee's April 24th hearing.

II. LAO -- Proposition 98 Analysis and Recommendations

In their budget analysis, the LAO provides the following findings and recommendations regarding Proposition 98 funding for K-12 education, as proposed by the Governor's budget.

LAO Proposition 98 Update

- **Updated Revenue Forecast Leads to Different Estimates for Proposition 98 Minimum Guarantee in Both the Current and Budget Years.** Because of lower estimates for General Fund revenues, our forecast suggests the minimum guarantee is \$609 million lower in 2006-07 and \$261 million higher in 2007-08, as compared to the administration's estimates.
- **For the First Time, Proposition 98 Funding Level Will Be Adjusted Downward to Reflect Declining Attendance.** After two years of being held harmless for statewide declines in student population, in 2007-08 the Proposition 98 minimum guarantee will be calculated using the actual change in K-12 average daily attendance (-0.4 percent). Overall Proposition 98 funding still increases compared to the current year.
- **Forecast Suggests Test 1 Factor Could Become Operative in Near Future.** Healthy growth in General Fund and local property tax revenues coupled with declining K-12 attendance result in a shrinking share of the General Fund going to Proposition 98. The LAO forecast suggests the Test 1 requirement—roughly 40 percent of all General Fund spending—could become operative as early as 2009-10.

LAO Proposition 98 Priorities

- **Proposition 98 Priorities.** Recommend Legislature reduce current-year Proposition 98 spending by \$609 million, which would reduce the 2007-08 minimum guarantee by \$634 million. These actions would help the state address its General Fund budgetary problem.
- **Maintain Priority on Reducing Debt.** Recommend Legislature use any additional Proposition 98 funds that materialize this year to pay for the ongoing cost of state-mandated local programs and reduce the state's "credit card" debt.

LAO Proposition 98 Roadmap

- **A Proposition 98 Roadmap.** A long-term roadmap could strengthen the Legislature's role in the annual budget process, increase its ability to pay for its high-priority policy initiatives, and help school and community college districts implement state initiatives more effectively.
- **Major Components of a K-12 Spending Roadmap.** Our roadmap includes two priorities goals: (1) investing in child development programs and supplemental funding programs for the major subgroups of K-12 students who perform well below state standards, and (2) helping districts address the long-term financial threat posed by retiree health insurance costs.
- **Implementing the LAO's Roadmap's K-12 Priorities.** Invest new discretionary Proposition 98 funds in three program areas: (1) child development programs, (2) existing programs that support supplementary services to low-performing and at-risk students, and (3) "fiscal solvency" block grants that would assist districts to pay for retiree health benefits.
- **Major Components of a California Community Roadmap.** Recommend using new discretionary Proposition 98 funds to: (1) pay off districts' outstanding liabilities through fiscal solvency block grants, and (2) improve completion rates through student success block grants.

ISSUE 2: Major Adjustments – Student Enrollment

DESCRIPTION: The Governor’s Budget estimates that K-12 education enrollment – as measured by average daily attendance (ADA) -- will decline by 0.39 percent from 2006-07 to 2007-08. According to the Legislative Analyst, the Governor’s proposed enrollment adjustments provide a net budget reduction (savings) of **\$71.6 million** in 2007-08.

BACKGROUND: The number of students enrolled in K-12 schools, as measured by ADA, is estimated by the Governor to decrease by 23,000 in 2007-08, a decline of 0.39 percent below the revised 2006-07 level. This attendance decline will bring total K-12 (ADA) to 5,918,000 in 2007-08. While enrollment rates have slowed since the mid-1990s, this reflects the third consecutive year of actual attendance decline for K-12 schools statewide.

According to Department of Finance (DOF) population estimates, K-12 enrollment levels will continue to decline over the next several years and will start climbing again in 2009-10. The recent decline in enrollment reflects the loss of children born to “baby-boomers” who are aging out of the K-12 schools – particularly high schools -- and a decline in birth rates beginning in the 1990s.

Enrollment	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 (Proposed)
Student ADA	5,813,779	5,915,493	5,966,626	5,983,774	5,964,000	5,941,000	5,918,000

Student enrollment changes play out quite differently for elementary schools and high schools than reflected by statewide trends overall. Elementary school enrollments slowed in the late 1990’s and have experienced actual declines since 2003-04. Elementary enrollments are expected to start growing again in 2008-09. High school enrollments grew steadily in the late 1990s through 2004-05 and since then have begun to slow. High school enrollments are projected to decline beginning in 2007-08 and are not expected to grow again until 2013-14.

Enrollment trends also differ greatly among school districts. Roughly half the school districts in the state (more than 500) are currently experiencing declining enrollment. The remaining districts are growing – some slightly and some rapidly. This issue will be discussed further in the next agenda item.

Most K-12 education programs – revenue limits and categoricals -- receive year-to-year statutory growth adjustments. These enrollment growth rates, reflecting the estimated changes in student attendance, are summarized below for the last several years. Categorical programs typically receive enrollment growth at budgeted rates; revenue limits, which are continuously appropriated, receive growth at adjusted rates.

Enrollment	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 (Proposed)
Budgeted Growth Rates	1.40	1.37	1.34	0.95	0.69	0	-0.39
Adjusted Growth Rates	1.71	1.77	0.99	0.43	-0.12	-0.36	NA

Statewide, student enrollment growth rates have been slowing since the mid-1990s when annual growth was budgeted at more than 2.5 percent, and finally turned negative in 2005-06. Despite estimated negative growth of 0.26 percent at May Revise, enrollment growth was budgeted at zero percent in 2006-07 for education programs to buffer K-12 education from the full effects of negative enrollment adjustments in the first year of the budgeted decline.

Governor's Budget Proposal: The Governor's Budget provides **\$71.6 million** in net reductions associated with various student enrollment adjustments between 2006-7 and 2007-08. Adjustments can be broken down into three major categories:

- **Statutory ADA Adjustments for Revenue Limit and Some Categorical Programs.** According to the LAO, the Governor proposes **\$110.4 million** in reductions for county and school district revenue limit apportionments to reflect changes in the ADA growth rate, estimated by the Governor at -0.39 percent for 2007-08. In addition, the Governor proposes **\$23.5 million** in reductions for 21 categorical programs, such as special education, targeted instructional improvement grants, professional development block grants, school and library improvement grants, and instructional materials that also have growth formulas tied to the ADA growth rate.
- **Hold Harmless for Selected Categorical Programs.** The Governor proposes to hold approximately 28 selected categorical programs harmless from negative growth rate adjustments because ADA-based adjustments are not clearly required by statute for the program and/or the program is new or was recently expanded. For these selected programs, the Governor's proposes to budget enrollment at the 2006-07 level, so there is a no (zero) enrollment adjustment in 2007-08. Economic Impact Aid is the largest program that the Governor proposes to protect from negative enrollment adjustments. Other large programs that are protected include: supplemental instruction, grade 7-12 school counseling, CAHSEE supplemental instruction, arts and music block grants, deferred maintenance, and home-to-school transportation. According to the LAO, the Governor's proposal to protect these programs from negative enrollment adjustments that would otherwise be incurred by programs results in costs of nearly \$13 million in 2007-08.
- **Adjustments for Categorical Programs with Separate Population Formulas.** The Governor proposes **\$62.3 million** in enrollment adjustment increases for 11 categorical programs with special statutory enrollment or other workload factors that are growing. Programs in this category include charter school block grants, ROC/Ps, adult education, class size reduction, school meals and six child care programs. The Governor proposes positive enrollment growth for all of these programs.

LAO Analysis: According to the LAO, the Governor's proposal to protect selected categorical programs from negative growth adjustments is discretionary and the Legislature could eliminate these proposed protections for all of these programs, which would create budget savings of **\$13 million** that could be used for other purposes in 2007-08. Alternatively, the Legislature could create a different list of programs to protect from negative growth adjustments that could cost more or less in 2007-08 depending upon the programs selected.

COMMENTS: The Department of Finance will update 2007-08 estimates of student enrollment as part of the Governor's May Revise to provide more up-to-date K-12 enrollment estimates. As suggested by the LAO, the Legislature has the option of decreasing funding for all the categorical programs the Governor proposes to protect from negative growth adjustments. This would create approximately **\$13 million** in savings that could be redirected for other purposes.

ISSUE 3: Major Adjustments – Declining Enrollment Districts

DESCRIPTION: The Governor’s Budget estimates **\$501 million** for revenue limit enrollment adjustments for school districts experiencing declining enrollment in 2007-08. This amount builds upon **\$476 million** in adjustments for school districts in 2006-07 and adds **\$25 million** in declining enrollment calculations for charter school students who return to school districts under a new state law.

BACKGROUND: Revenue limit funding is calculated by multiplying revenue limit rates for school districts times student enrollment, which is calculated by average daily attendance (ADA). State statute allows school districts that are experiencing declining student enrollment to *delay* revenue limit reductions associated with enrollment declines for one year. Declining enrollment districts can choose to use prior year enrollment as the basis of their revenue limit funding to soften the impact of enrollment based funding losses.

The Governor’s budget estimates that the costs of declining enrollment total **\$501 million** in 2007-08. This estimate reflects 2006-07 costs of **\$476 million** and adds **\$25 million** to conform to Chapter 653; Statutes of 2006 (SB 1446/Perata). This new law changes the way charter school students are counted for purposes of declining enrollment when they return to school districts. Specifically, the bill allows school districts to deduct, from their prior year enrollment losses, students returning to their district from charter schools.

The CDE reports that a total of **536 school districts** experienced declining enrollment in 2005-06 – the latest actual data available. As indicated in the previous item, K-12 attendance overall will continue to decline for the next several years and begin to grow again beginning in 2009-10. For this reason, it is estimated that a large number of districts will continue to face declining enrollment

As the number of declining enrollment districts have risen, so too have the costs of declining enrollment revenue limit adjustments. As a result, the DOF started to include estimates of declining enrollment adjustments in their annual revenue limit adjustments. The following table summarizes increases in the declining enrollment adjustments in recent years utilizing data from DOF and CDE.

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 (Estimated)
Statewide Growth Rate	2.10%	1.75%	0.85%	0.30%	-0.33%	-0.39%	-0.39%
Districts Receiving Declining Enrollment Adjustment	329	375	413	439	536	NA*	NA*
Difference Between Prior Year ADA & Actual ADA for Declining Districts	16,000	19,000	28,000	50,000	78,000	NA*	NA*
Costs of Declining Enrollment	\$75 m	\$90 m	\$135 m	\$246 m	\$402 m	\$476 m	\$501 m
* Data Not Available							

LAO Recommendations: The LAO concurs with DOF estimates of declining enrollment costs reflected in the Governor’s 2007-08 budget. In previous years, DOF utilized past-year costs adjusted for COLAs as the method for estimating declining enrollment adjustments for the Governor’s budget. In their analysis last year, the LAO found that this methodology underestimated costs and recommended a new methodology using the current district-level attendance data and DOF long-term enrollment projections. The Governor adopted this new methodology at May Revise last year.

COMMENTS: This issue is raised for information purposes only to highlight the significant, growing state costs of declining enrollment adjustments for school districts under current law.

ISSUE 4: Major Adjustments – Cost-of-Living Adjustments (COLAs)

DESCRIPTION: The Governor’s Budget provides **\$1.9 billion** to fully fund statutory COLAs for K-12 revenue limit and categorical programs in 2007-08. This provides a **4.04 percent** COLA for revenue limits and categorical programs. COLAs provide discretionary funding to local education agencies.

BACKGROUND: The annual budget provides K-12 education programs with COLAs for all revenue limit programs and most categorical programs. COLAs are provided to address higher annual costs to schools resulting from inflation. Most education programs receive this adjustment through statute (revenue limits and most categorical programs), while some categorical programs (home-to-school transportation, etc.) typically receive discretionary COLAs in the budget. COLAs are applied to state education programs, not to federal programs. Budgeted COLAs for the last several years are summarized below:

COLA Rates	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 Proposed
Budgeted	3.17	3.87	2.0	0	2.41	4.2	5.92	4.04

The 2006-07 budget provided a 5.92 percent COLA to education programs – the highest COLA in at least twenty years. At this high rate, K-12 education programs received \$2.6 billion in new discretionary funds in 2006-07.

In contrast, the 2003-04 budget did not fund any COLA for K-12 revenue limit and categorical programs due to a budget shortfall that year. Deficit factors were created for revenue limits as a result of these foregone cost-of-living adjustments and additional revenue limit reductions. This revenue limit deficit factor balance totaled more than \$800 million in 2003-04 and was paid-off over several years. The 2006-07 provided a final payment of \$308.6 million to eliminate any outstanding revenue limit deficit obligations for school districts and county offices of education. This funding fully restores revenue limits to where they would have been without these reductions.

Governor’s Budget Proposal: The Governor’s Budget proposes **\$1.9 billion** to fully fund statutory COLAs for K-12 revenue limits and categorical programs in 2007-08. The Governor estimates a 4.04 percent COLA, which provides **\$1.4 billion** for revenue limits and **\$515.7 million** for categorical programs that either require a COLA pursuant to state statute or tradition. The table below provides additional breakdowns of proposed COLAs for revenue limits and some categorical programs in 2007-08.

Dollars in Millions	Estimated COLA Rate	COLA \$: Revenue Limit	COLA \$: Special Education	COLA \$: Child Care	COLA \$: Other Categorical Programs	COLA \$: TOTAL
Governor’s Budget	4.04%	\$1,383.6	\$133.0	\$66.0	\$316.7	\$1,899.3

LAO Analysis: Estimation of the COLA for K-12 education (and community colleges) relies upon the gross domestic product deflator for purchases of goods and services by state and local governments (GDPSL). The Governor’s COLA estimates reflect two quarters of GDPSL growth rates available when the budget was prepared. According to the LAO, the additional quarter of GDPSL rates available since then are consistent with the figures budgeted by the Administration in January.

COMMENTS: The Department of Finance will update COLA estimates as part of the Governor’s May Revise to reflect four quarters of GDPSL growth rates. According to the LAO, COLA rates at May Revise are likely to be very close to the Governor’s current budget year estimate of 4.04 percent.

ISSUE 5: Major Adjustments – Home-to-School Transportation Shift

DESCRIPTION: The Governor proposes to shift **\$627 million** in funding for the Home-to-School Transportation program from Proposition 98 General Fund to the Public Transportation Account (PTA). In making this shift, the Administration proposes to rebench the Proposition 98 minimum guarantee downward by **\$627 million** to reflect the savings in state General Funds. The Governor includes a 4.04 percent COLA for this program in 2007-08.

BACKGROUND: The Home-to-School Transportation program provides funding for school districts to purchase and operate school buses for transporting students to and from school. Recent data indicate that almost all school districts (930) participate in the program, transporting a total of approximately 936,000 students (including special education students), or about one in six K-12 students. Participation in the program has been limited to only those districts which participated in the early 1980s. At this time, a base year of funding was established for each district, which has been adjusted over the years at the discretion of the Governor and Legislature. There are no statutory requirements for enrollment adjustments or COLAs. However, COLA increases have typically been provided for the program.

LAO Analysis: The LAO raises a variety of concerns with the Governor's proposal, including, but not limited to, its legality. First, the LAO believes that the re-benching of Proposition 98, which is the primary reason for the funding shift, is likely unconstitutional. According to the LAO, the State Constitution does not contain language authorizing such a re-benching of the minimum guarantee. Further, the LAO notes that the Governor's proposal runs contrary to the intent of the voters when they passed Proposition 98, which was to insulate K-14 from competing state funding priorities.

The LAO further expresses concern with the stability of the Public Transportation Account (PTA) as a funding source for the Home-to-School Transportation Program. While school bus transportation appears to meet the definitional requirements to receive PTA funding, it remains uncertain as to whether the PTA will have sufficient ongoing funds to support the program. The LAO notes that the revenue streams for the PTA, which fluctuate based on changes in gasoline prices and the economy in general, are very volatile, and as such, may not be able to support this program past 2007-08.

The LAO, as well as the Department of Education, are particularly worried about the Home-to-School Transportation program losing the protections granted under Proposition 98 with the Governor's proposed shift. The LAO believes that this shift sets a bad precedent and may allow future Administrations and Legislatures to shift historically, Proposition 98 funded programs out from under their constitutionally protected shelters any time the state needed to achieve fiscal savings. Once the program is removed from the protections offered by Proposition 98, the state could then choose to defund the program in the future, realizing even greater ongoing savings. As a result, the vision enacted by the voters with the passage of Proposition 98 would now be rendered meaningless.

LAO Recommendation: The LAO recommends that the Legislature reject the Governor's proposal to fund the Home-to-School Transportation program from the Public Transportation Account and rebench the Proposition 98 guarantee by a like amount.

Comments: Given the strong concerns from the LAO about the legality of the Governor's proposed Home-to-School Transportation funding shift, this does not appear to be a viable budget proposal. In response to the LAO's concerns, the Administration still believes their proposal works legally, although they have also indicated they are looking at alternatives.

ISSUE 6: Education Mandates –Annual Payments (6110-295-0001)

DESCRIPTION: The Governor proposes to continue the practice of deferring payments for annual education program mandate claims in 2007-08. This practice arose in recent years as a means to achieve short-term budget savings. The annual cost of education mandates is estimated at approximately **\$160 million** for K-12 schools.

BACKGROUND: Several years ago, funding for education mandate programs costs basically stopped, and payments were deferred to future years or suspended. This action was taken to reduce expenditures given the fiscal circumstances that year and in subsequent years. By deferring reimbursement of mandate claims, the state does not eliminate obligations. The state must eventually pay all claims, once audited and approved. The state must also pay interest on overdue claims, based upon the rate established for the Pooled Money Investment Account. The LAO estimates that the state paid **\$48.6 million** in interest on the unpaid mandates through 2002-03, the latest figure available.

Governor's Budget Proposal: The Governor proposes to defer payments for the annual costs of 38 mandated education programs for K-12 school districts and county offices of education in 2007-08. The Governor retains a total of \$38,000 or \$1,000 for each of these mandates, however the Governor proposes to defer an estimated **\$160 million** in annual payments for these mandates in 2007-08. This continues the practice in recent years of deferring or suspending annual mandate payments to achieve short term budget savings.

In addition, the Governor is proposing to defer \$25 million in annual payments for community college mandates that brings the total mandate deferral amount to \$185 million for K-14 education in 2007-08.

The Governor also proposes to continue suspension of four K-12 education mandate programs in 2007-08, including: School Bus Safety I & II; Law Enforcement Sexual Harassment Training; County Treasury Withdrawals, and Grand Jury Proceedings.

LAO Recommendation: In previous analyses the LAO has consistently recommended restoration of funding for annual, ongoing education program mandates in order to reduce "education credit card" debt. However, given the shortage of new, ongoing Proposition 98 funding in 2007-08, the LAO is not making this recommendation. Instead, the LAO recommends that if new funds become available during the budget process, the Legislature give high priority to paying the annual costs of state-mandated local programs.

Governor's Local Mandate Reform Proposal: The Governor's budget proposes significant reforms as a part of the 2007-08 budget that, according to the Department of Finance, apply to K-12 education and community colleges, as well as, other local government mandates. According to the LAO, the Governor's proposal would change the process the state utilizes to (1) determine whether a reimbursable mandate exists and (2) specify the method for determining reimbursement. The LAO believes that the Governor's mandate reform proposal provides a good starting point for discussion. In their recommendation, the LAO offers a similar proposal for the Legislature to consider, which is outlined in the LAO's *Perspective and Issues* publication.

Comments: Staff supports the LAO recommendation to defer \$160 million in annual K-12 mandate payments in 2007-08 given the estimated shortage of new, ongoing Proposition 98 funds in the budget year. However, if new funds become available, LAO recommends giving priority to paying the annual costs of state-mandated local programs.

The LAO has also recommended major reforms in the past to address the local mandate process for K-14 education. The Subcommittee has heard several of these LAO proposals in recent years. Now the Governor is proposing similar reforms. The Governor's proposed local mandate reforms and LAO recommended reforms provide important options for the Legislature to consider in 2007-08.

The Governor's Local Mandate Reform Proposal will be heard by Senate Budget Subcommittee #4 as a part of the Commission on State Mandates Budget item on March 8th. Now that the Department of Finance has confirmed that this proposal applies to K-14 education, Subcommittee #1 may want to consider hearing this issue separately at a future date.

ISSUE 7: Education Mandates – Prior Year Payments

DESCRIPTION: The Governor also proposes no additional funding to pay for outstanding prior year K-12 education mandate claims. Per the LAO, the total outstanding mandate obligation for K-14 education will total **\$550 million** in 2007-08. This includes \$435 million for K-12 and \$115 million for community colleges. It is important to note that the state must eventually pay all claims, once audited and approved, and that the state must also pay interest on overdue claims, based upon the rate established for the Pooled Money Investment Account.

BACKGROUND: As a result of the continuing practice of deferring annual mandate payments for K-12 education, the state had accumulated more than **\$1.2 billion** in outstanding mandate payments by the end of 2005-06 according to the LAO. An additional \$100 million in outstanding deferrals for community colleges brought the total to \$1.3 billion.

Given significant one-time revenues available, the 2006-07 budget appropriated \$967 million to payoff K-14 education mandates. Of this amount, \$927 million was appropriated to reimburse school districts and county offices of education for outstanding, prior year education mandate claims. As indicated by the table below, funding was provided through from several sources that were appropriated in the 2006-07 budget act and education budget trailer bill (Chapter 79; Statutes of 2006).

Prop 98 - Prior Year Mandate Expenditures	K-12	CCC	TOTAL
Current Year Settle-Up	650,062,000	15,000,000	665,062,000
Prior Year Settle –Up for 06-07 (Ch.216/2004)	133,189,000	0	133,189,000
Prior Year Settle –Up for 07-08 (Ch.216/2004)	125,000,000	25,000,000	150,000,000
Prop 98 Reversions	18,726,000		18,726,000
TOTAL	926,977,000	40,000,000	966,977,000

Chapter 216, Statutes of 2004 (SB 1108/Committee on Budget and Fiscal Review), the 2004-05 education budget trailer bill, requires the state to begin appropriating **\$150 million** a year beginning in 2006-07 for Proposition 98 settle-up repayment and specifies that any such funds must first be applied in satisfaction of unpaid mandate claims. The 2006-07 payment was partially pre-paid by the 2005-06 budget and fully paid by the 2006-07 budget. The 2007-08 payment was fully prepaid by the 2006-07 budget.

Estimated Outstanding Obligations in 2007-08: According to the LAO, the outstanding mandate balance for K-14 education will total **\$365 million** by the end of 2006-07 -- \$275 million for K-12 education and \$90 million for community colleges. These amounts reflect the deferral of more than \$100 million in annual mandates costs in 2006-07. (Another \$30 million in one-time funds was provided for annual mandate payments in 2006-07.)

With the Governor's proposed deferral of \$185 million in K-14 mandate payments in 2007-08, the total outstanding mandate obligation for K-14 grows to **\$550 million** in 2007-08, per the LAO. This includes \$435 million for K-12 education and \$115 million for community colleges.

COMMENTS: As indicated by the last item, the LAO generally recommends that the Legislature place a high priority on paying off the costs of its "education credit card" and has recommended major reforms in the past to address the local mandate process. The Governor's proposed local mandate reforms and LAO recommended reforms provide important options for the Legislature to consider in 2007-08.

ISSUE 8: Implementation Update: Status of New One-Time Funds in 2006-07

DESCRIPTION: The California Department of Education will update the Subcommittee on the implementation status of approximately **\$1.6 billion** in new one-time funds appropriated in the 2006-07 budget for new or expanded programs. The department will utilize a summary they prepared entitled *2006-07 Budget Actions and Program Funding Information* (see Attachment) in providing this update.

BACKGROUND: The 2006-07 budget appropriated **\$2.8 billion** in one-time Proposition 98 funds in 2006-07 for K-12 education and community colleges, reflecting a \$2.3 billion increase in 2005-06 Proposition 98 funding resulting from significant new revenues, and other one-time funds including \$283 million from prior year settle-up payments and \$248 from the Proposition 98 Reversion Account.

Of the \$2.8 billion in one-time funds in 2006-07, **\$2.5 billion** is provided for K-12 education for several new programs. These funds are summarized in the following table prepared by the Legislative Analyst's Office.

K-12 Spending From One-Time Funds	
<i>2006-07 (In Millions)</i>	
	Amount
Payment of K-12 mandate claims from prior years	\$927
Discretionary block grant	534
Arts, music, and P.E. equipment block grant	500
School facilities emergency repairs (<i>Williams</i> settlement)	137
Instructional materials	100
Preschool facilities	50
Teacher recruitment	50
Career technical education equipment	40
Mandates—2006-07 costs	30
Other	165
Total	\$2,533

Source: *California Spending Plan, 2006-07*, Office of Legislative Analyst.

While \$957 million of these one-time funds were appropriated for payment of outstanding education mandates, the remaining **\$1.6 billion** were appropriated for a number of new programs or to expand some existing programs.

Comments: The Department of Education is implementing new, ongoing funding allocations for a number of new or expanded programs in 2006-07. It will be helpful for the department to identify any major problems they are having with implementation of these new, one-time funds early in the budget season so that these issues can be addressed through the budget process. For example, have there been significant delays in allocating funds to local education agencies and, if so, what is the likelihood that funds appropriated will be fully expended in 2006-07?

ISSUE 9: Implementation Update: Status of New Ongoing Funds in 2006-07

DESCRIPTION: The California Department of Education will update the Subcommittee on the implementation status of approximately **\$1.4 billion** in new, ongoing funds appropriated in the 2006-07 budget for new or expanded programs. The department will utilize a summary they prepared entitled *2006-07 Budget Actions and Program Funding Information* (see Attachment) in providing this update.

BACKGROUND: The 2006-07 budget appropriated an additional \$5.2 billion (10.3 percent) in Proposition 98 funding for K-12 education and community colleges above the enacted 2005-06 budget. Of this amount, **\$4.5 billion** was provided in new, ongoing funding for K-12 education as summarized in the table prepared by the LAO.

Ongoing K-12 Proposition 98 Changes	
2006-07 (In Millions)	
	Amount
Cost-of-living adjustments, growth, and other adjustments	\$2,383
Proposition 49 after-school programs	426
Revenue limit equalization	350
Economic Impact Aid	350
Deficit-factor reduction (including basic aid)	309
Counselors	200
Arts and music block grant	105
Child care eligibility	67
Preschool expansion	50
Increased support for high school exit exam	50
Other	187
Total Changes	\$4,476

Source: *California Spending Plan, 2006-07*, Office of Legislative Analyst.

More than \$3.0 billion of the new ongoing funds appropriated in 2006-07 provide discretionary funding for K-12 local education agencies. These discretionary funds include COLA and growth adjustments, revenue limit equalization funding, and revenue limit deficit factor elimination. However, the remaining **\$1.4 billion** is appropriated for new programs or to expand existing programs -- largely programs administered by the Department of Education.

Comments: The Department of Education is implementing new, ongoing funding allocations for a number of new or expanded programs in 2006-07. It will be helpful for the department to identify any major problems they are having with implementation of these new, one-time funds early in the budget season so that these issues can be addressed through the budget process. For example, have there been significant delays in allocating funds to local education agencies and, if so, what is the likelihood that funds appropriated will be fully expended in 2006-07? For ongoing funds, does the department need additional direction or clarification in allocating funds to local education agencies in order to reflect the intent of the Legislature?